Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Rainey	Analyst:	Kristina North	Bill Number:	SB 1438
Related Bills:	See Legislative History	Telephone:	845-6978	Introduced Date:	February 7, 2000
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Parent or Teacher Qualifying Educational Expenses Credit

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would allow a 100% credit for up to $200 of qualifying educational expenses paid or incurred by a parent or a teacher at a qualifying educational institution.

EFFECTIVE DATE

This bill would be effective immediately upon enactment and would apply to taxable years beginning on or after January 1, 2000.

LEGISLATIVE HISTORY

AB 1358 (1997/1998 Pringle) would have allowed a credit equal to 100% of the amount of any contribution by a taxpayer to a public school.

AB 336 (1997/1998 Miller) would have allowed a credit for qualifying classroom educational expenses, up to $500, paid or incurred by a qualified teacher at a qualifying educational institution.

Both bills failed passage in the Legislature.

SPECIFIC FINDINGS

Current state and federal laws do not allow a tax deduction for personal expenses, except where specifically authorized. Alimony paid is deductible as an adjustment to gross income. Medical expenses, charitable contributions, interest, and taxes are deductible as itemized deductions. Expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions and must exceed 2% of adjusted gross income (AGI) to be deducted as an itemized deduction. Purchases by teachers for their classrooms that are considered an ordinary and necessary business expense may be claimed as miscellaneous itemized deductions.

Current state and federal laws allow a deduction for materials donated directly to a school or school district as a charitable contribution if the donor retains no control over how the materials are used.

Federal and state laws provide for various tax credits designed to provide tax relief for taxpayers who incur expenses (e.g., joint custody head of household or dependent parent credit) or to influence business practices and decisions.

Board Position:			Department Director	Date
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Federal law allows several tax benefits for education (the Hope Learning Credit, the Lifetime Learning Credit, and an interest deduction on certain student loans), but these relate to expenses associated with post-secondary education. Neither state nor federal laws currently allow a credit for educational expenses relating to the K through 12 schooling of a child.

Under the PITL, **this bill** would allow a 100% credit of up to $200 for qualified educational expenses paid or incurred during a taxable year by any teacher or parent at a qualifying public educational institution.

This bill defines:

- "qualified educational expenses" as costs paid or incurred by a teacher or parent for school supplies to be used by a student in the classroom, including, but not limited to pens, pencils, paper, calculators, backpacks, books, and similar items.

- "qualifying educational institution" as any public elementary, secondary, or vocational-technical school in this state providing education for grades K-12, inclusive.

This bill would provide that the credit be in lieu of any deduction the taxpayer would otherwise be entitled to claim for the same expenses.

This bill would provide that a taxpayer may carry over any excess credit until exhausted.

Policy Considerations

Credits generally are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, up to $200 annually.

Public schools are funded by state and local government. If the author's intent is to provide state funding for school supplies at public schools, a direct appropriation of funds may be more effective in accomplishing the author's intent.

This bill does not include a sunset date or limit the number of years for the carryover. Credits are typically enacted with a repeal date to ensure that the legislature reviews their effectiveness. Experience has shown that most credits are exhausted within eight years. Without a carryover limit, the credit indefinitely remains on the tax return.

This bill does not specify that the expenses upon which this credit is claimed may not be reimbursed.

Implementation Consideration

Because this bill does not require certification of the amounts paid or incurred and no relationship is required between the student and the taxpayer claiming the credit, this credit would be difficult for the department to audit. Additionally, because this broad-based credit potentially would be claimed by more than two million taxpayers, it would not be practical to require schools to provide certification of this credit.

Technical Considerations

In the authorization paragraph, this bill allows a credit for qualified educational expenses that are paid or incurred by a teacher or parent "at a qualifying educational institution." This language could limit qualifying expenses to those incurred exclusively at the qualifying educational institution (such as through an on-campus bookstore), while precluding purchases from other off-campus sources (e.g., retail establishments). The author may wish to consider specifying that the expenses are "for use at a qualifying educational institution."

In the definition of "qualified educational expenses," after the word "items" and before "Qualifying educational institution," a period and "(2)" are missing. Amendment 1 is provided.

FISCAL IMPACT

Departmental Costs

If the implementation concern can be s resolved, this bill would not significantly impact the department's costs.

Tax Revenue Estimate

Based on the data and assumptions discussed below, the revenue losses from this bill are estimated as follows:

Estimated Revenue in **Millions** Impact of AB 1438 As Introduced February 7, 2000 Taxable Years Assumed After 12/31/1999 and Enactment After 6/30/2000			
Fiscal Years	2000/2001	2001/2002	2002/2003
Revenue Impact (Rounded)	**-435**	**-400**	**-410**

Any possible changes in employment, personal income, or gross state product that might result from this provision are not taken into account.

Tax Revenue Discussion

Revenue losses would depend on the amount of qualified credit claims generated in any given year. It was assumed that the maximum credit ($200) would be on a taxpayer basis rather than per child basis.

According to departmental data (PIT simulation model), the number of taxable returns filed with dependents is projected to be nearly 3 millions for tax year 2000. The number was reduced by 20% to allow for dependents other than K-12 age and private school students.

The number of teachers (full-time equivalents) in these public schools was nearly 290,000 for school year 1996/1997. This number was increased by 15% to allow for part-time and substitute teachers and a 2% annual growth rate was applied to project the number of qualified teachers for year 2000/2001 (approximately 360,000).

To exclude teachers who also would qualify as parents of eligible students, a two-thirds reduction was applied leaving nearly 120,000 qualified teachers claiming credits.

The impact for tax year 2000 reflects nearly 2.2 million qualified parents and teachers each applying $200 against their available tax liabilities.

The 2000/2001 fiscal year estimate includes all of the 2000 impact plus 10% of the 2001 impact to allow for reduced estimated tax payments for some taxpayers.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1438
As Introduced February 7, 2000

AMENDMENT 1

On page 2, delete lines 9 and 10 and insert:

backpacks, books, and similar items.

(2) "Qualifying educational institution" means any public elementary,